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KETUA PENGARAH HASIL DALAM NEGERI

v.

FIRGOS (M) SDN BHD

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HIGH COURT MALAYA, KUALA LUMPUR
ZALEHA YUSOF J
[CIVIL APPEAL NO: R2-14-9-09-2012]
30 JANUARY 2013

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REVENUE LAW: *Income Tax - Reinvestment allowance - Claim for - Claim for reinvestment allowance dismissed by Securities Commissioners of Income Tax ('SCIT') - Appeal against Deciding Order of SCIT - Whether reinvestment allowance could be claimed on capital expenditure incurred for production area only - Whether SCIT exercised discretion properly and lawfully in imposing penalty under s. 113(2) Income Tax Act 1967*

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The respondent was in the business of manufacturing papers, cards and boards which included sheeting, processing and trading papers, cards and boards. The respondent had claimed for reinvestment allowance in the years of assessment 2005 and 2007 amounting to RM3,193,853 and RM205,964 respectively. After conducting a field audit at the respondent's premise, the appellant disallowed the reinvestment allowance claims made by the respondent. However, the Special Commissioners of Income Tax ('SCIT') allowed the respondent's appeal. It was the appellant's contention that the respondent was only entitled to reinvestment allowance on the capital expenditure incurred for the production area only. The appellant also contended that the SCIT had erred when they held that the words "existing business" must be read together as a whole. Therefore, the appellant appealed by way of a case stated pursuant to para. 34 sch. 5 of the Income Tax Act 1967 ('Act') against the deciding order of SCIT. The issues that arose for determination *inter alia* were (i) whether the items claimed by the respondent in the years of assessment 2005 and 2007 qualified for reinvestment allowance under the Act; and (ii) whether the appellant correctly exercised its discretion in imposing penalty under s. 113(2) of the Act in the year of assessment 2007.

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Held (dismissing appeal with costs):

(1) The functionality of the disputed items in the overall context of the respondent's manufacturing activity ought to be taken as a valid factor in considering the respondent's reinvestment allowance claim. The warehouse areas were essential and inherent in the nature of the respondent's business. Site preparation for plant installation was also vital and formed an integral and incidental part of the respondent's manufacturing activity. The installation of the fire-fighting equipments was a requirement by the Fire Department, without which the respondent would not have obtained the Certificate of Fitness to occupy the factory. If the respondent's raw materials were to catch fire and there was no fire-fighting equipment installed in the factory, the respondent's business operations would be disrupted and the respondent would also suffer losses. Hence, the installation of fire-fighting equipment was necessary for the construction of the factory as the respondent's raw materials were highly inflammable. (paras 11-14)

(2) The words 'existing business' found before the words 'in respect of manufacturing or processing of a product' must be read together as a whole, so that the expression 'existing business in respect of manufacturing or processing of a product' was the more probable expression which was consistent with the intention of the Legislature in enacting para. 8(a) of Schedule 7A. By imposing the condition of 'production area' to the meaning of 'manufacturing', the appellant had clearly acted *ultra vires*, illegally and without jurisdiction as such was never the intention of Parliament. (para 15)

(3) The capital expenditures claimed for reinvestment allowance purposes were actually incurred by the respondent. The respondent had made full disclosure in the forms that were submitted in the Years of Assessment 2005-2007 and agreed that the audit team did not discover anything contrary to the information disclosed in the forms. The respondent had acted in good faith and made full disclosure. Section 113(2) of the ITA conferred the appellant with the discretion of the imposition of penalty. The matter in dispute arose due to a differing interpretation of the tax legislation by the respondent. Therefore, the decision of the SCIT was correct. (para 17)

Case(s) referred to:

Ketua Pengarah Hasil Dalam Negeri v. Kim Thye & Co [1992] 4 CLJ 2079; [1992] 1 CLJ (Rep) 135 SC ***(refd)***

Ketua Pengarah Dalam Negeri v. Success Electronics and Transformer Manufacturer Sdn Bhd (Rayuan Sivil No: R1-14-14-09) (Unreported) ***(foll)***

Metacorp Development v. Ketua Pengarah Hasil Dalam Negeri [2011] 1 LNS 1002 HC ***(refd)***

Legislation referred to:

Income Tax Act 1967, s. 113(2), para. 1 Sch. 7A, para. 8(a) Sch. 7A, para. 34 Sch. 5

For the appellant - Neng Juliana Ismail (Wan Hamdenie Wan Mohamed with her); Inland Revenue Board

For the respondent - Palpanaban Devarajoo (Saravana Kumar Segaran & Donovan Lee Shyun Hun with him); M/s Lee Hishammuddin Allen & Gledhill

Reported by Sandra Gabriel

JUDGMENT

Zaleha Yusof J:

[1] The appellant is appealing by way of a case stated dated 4 September 2012 pursuant to para. 34 Sch. 5 of the Income Tax Act 1967 ("ITA") against the deciding order of the Special Commissioners of Income Tax ("SCIT") dated 4 May 2012.

[2] By that deciding order, the SCIT, unanimously allowed the appeal by way of Form Q filed by the respondent against the following assessment raised by the appellant ("the assessment"):

Date of Form Q	Year & Type of assessment	Date Of Notice	Tax assessed (RM)
27.8.2009	2005 (Additional)	29.7.2009	19,305.20
27.8.2009	2006 (Additional)	29.7.2009	294,233.72
27.8.2009	2007 (Additional)	29.7.2009	427,689.09

[3] The material part of the deciding order, which can be seen at pp. 51-52 of the case stated dated 24 December 2010, read as follows:

ADALAH DIPUTUSKAN bahawa semua perkara yang Perayu menuntut dalam tahun-tahun taksiran 2005 dan 2007 layak untuk dibenarkan tuntutan Elaun Pelaburan Semula di bawah Akta Cukai Pendapatan 1967 seperti berikut:

(a) Loji dan jentera

Tahun Taksiran 2005

(i) fire-fighting equipment; dan

(ii) electrical fittings

(b) Kilang

Tahun Taksiran 2005

(i) warehouse spaces

Tahun Taksiran 2007

(i) site preparation for the installation of the plant

ADALAH DIPUTUSKAN JUGA bahawa Responden tidak wajar mengenakan penalty di bawah Seksyen 113(2) Akta Cukai Pendapatan 1967 dalam Tahun Taksiran 2007.

[4] The respondent is in the business of manufacturing papers, cards and boards which includes sheeting, processing and trading papers, cards and boards. The respondent had claimed for reinvestment allowance in the years of assessment 2005 and 2007 amounting to RM3,193,853 and RM205,964 respectively. The appellant, after conducting a field audit at the respondent's premise *vide* its letter dated 18 July 2009, disallowed the reinvestment allowance claims made by the respondent on the following items:

Year of assessment 2005

Plant and machinery

(i) Fire-fighting equipment (the appellant disallowed the whole capital expenditure incurred amounting to RM290,000); and

(ii) Electrical fittings (the appellant disallowed 8/11 of the capital expenditure incurred amounting RM245,000).

A Factory:

8/11 or 72.7% of the factory which is the warehouse spaces.

Consequently, the appellant disallowed 8/11 of the capital expenditure incurred on the factory which amounts to RM1,811,378.

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Year of assessment 2007

Factory:

Site preparation for the installation of plant (the appellant disallowed the whole capital expenditure incurred amounting to RM229,000).

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The appellant informed the respondent that the reinvestment allowance claims for the Disputed Items were disallowed due to the following basis:

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(i) The production area which qualified for reinvestment allowance was 3/11th or 27.3% of the total floor area;

(ii) Only 27.3% of the total expenditure of electrical installation is allowed;

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(iii) The appellant had disregarded the respondent's claim for reinvestment allowance for fire-fighting equipment;

(iv) Capital expenditure for the preparation of site for the installation of plant and machinery is not eligible for reinvestment allowance under Schedule 7A of the Income Tax Act 1967;

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(v) The reinvestment allowance disallowed by the appellant in respect of the Disputed Items in the relevant years of assessment are as follows:

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Year of Assessment	Reinvestment allowance disallowed
2005	RM1,367,695
2007	RM13,740

(vi) On 29.7.2009, the appellant raised notices of additional assessment ("Form JA") including penalties amounting respectively RM19,305.20 and RM427,689.09 for the years of assessment 2005 and 2007.

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(vii) On 27.8.2009, the respondent filed a notice of appeal ("Form Q") dated 27.8.2009 against the appellant's decision in disallowing the reinvestment allowance claimed on the Disputed Items.

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[5] The SCIT had, as mentioned earlier, allowed the respondent's appeal. Hence, the appellant now appeals before this court.

Issues

Issue 1: Reinvestment Allowance

[6] Whether any or all of the following items claimed by the respondent in the years of assessment 2005 and 2007 qualify for reinvestment allowance under the Income Tax Act 1967:

(a) Plant and machinery:

Year of assessment 2005:
(i) fire-fighting equipment; and
(ii) electronic fittings

(b) Factory

Year of assessment 2005:
(i) warehouse spaces.

Year of assessment 2007:

(i) site preparation for the installation of plant.

Issue 2: Penalty

[7] Notwithstanding the above, whether the appellant exercised its discretion properly and lawfully in imposing penalty under s. 113(2) of the Income Tax Act 1967 in the year of assessment 2007?

Decision

[8] It is appellant's contention that the respondent was only entitled to reinvestment allowance on the capital expenditure incurred for the production area only. The appellant also contends that the SCIT had erred when they relied on the decision of the High Court in *Ketua Pengarah Dalam Negeri v. Success Electronics and Transformer Manufacturer Sdn Bhd* (Rayuan Sivil No: R1-14-14-09); and when they held that the words "existing business" must be read together as a whole.

[9] Reinvestment allowance is available where a taxpayer has incurred capital expenditure on a factory, plant or machinery for the purposes of a qualifying project. Paragraph 1 of Sch. 7A of the ITA reads:

A Subject to this Schedule, where a company which is resident in Malaysia:

(a) has been in operation for not less than twelve months; and

(b) has incurred in the basis period for a year of assessment
B capital expenditure on a factory, plant or machinery used in Malaysia for the purposes of a qualifying project referred to under subparagraph 8(a) or (b),

there shall be given to the company for that year of assessment a reinvestment allowance of an amount equal to sixty percent of
C that expenditure.

[10] In *Success Electronics'* case (*supra*), the High Court had affirmed the SCIT's decision that reinvestment allowance cannot be restricted to "production area" alone. In that case, the High
D Court held that meeting room, office spaces, toilets, staircases, void areas, lift lobby, surau, warehouse, lightning adjustment and installations of air-conditioning, electrical fitting and partition walls were part of the factory. The High Court had affirmed the SCIT's decision and approved the following principles:

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(a) The word 'factory' was not defined for the purpose of this reinvestment allowance … in the absence of such express definition to the word 'factory', the word should then be given its ordinary meaning.

F (b) A factory is a building that is used to manufacture goods which may contain areas for production and non-production.

(c) The imposition of the condition "production area" based on internal ruling or guidelines of the respondent are without any legal authority and therefore had no force of law.

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(d) The respondent is not entitled to reduce or to disallow the reinvestment allowance claimed under Schedule 7A of the Act based on its own internal ruling or guidelines.

(e) The functionally of the claimed items in the overall context
H of the manufacturing process ought to be taken as a valid factor to be considered in giving the appropriate meaning to the word 'factory'.

(f) If the Parliament had intended for the word 'factory' to be narrowly interpreted to mean as was submitted by the
I Respondent, then an express definition, different from the one provided for the term factory in Schedule 2, ought to have been so provided in Schedule 7A.

[11] I agree with the respondent that the principle enunciated in *Success Electronics'* case (*supra*) shall be applicable here. As submitted by the respondent, the functionality of the disputed items in the overall context of the respondent's manufacturing activity ought to be taken as a valid factor in considering the respondent's reinvestment allowance claim.

[12] I also agree with the respondent that the warehouse areas are essential and inherent in the nature of the respondent's business. Even the appellant's witness agreed that the respondent's raw materials occupy a large amount of space. Without the raw materials, there would be no production. Since the respondent's raw materials are highly flammable, surely it is also good practice standard to have large spaces.

[13] To me, site preparation for plant installation was also vital and formed integral and incidental part of the respondent's manufacturing activity, without which its activity would not be able to function adequately. The appellant's witness admitted in evidence that the installation of the fire-fighting equipments was a requirement by the fire department to ensure the safety of the factory and staff, without which the respondent would not have obtained the certificate of fitness to occupy the factory. If the respondent's raw materials were to catch fire and there was no fire-fighting equipment installed in the factory, the respondent's business operations would be disrupted and the respondent would also suffer losses. Hence, I agree with the respondent that the installation of fire-fighting equipment was necessary for the construction of the factory as the respondent's raw materials are highly inflammable.

[14] The appellant submits that the words "... in respect of manufacturing or processing of a product ..." in para. 8(a) of Sch. 7A is a phrase that needs to come into heavy consideration in determining the respondent's eligibility to reinvestment allowance. They further submits that manufacturing process/activity is a process of production of articles for use from raw or prepared materials by giving such materials new forms, qualities, properties or combinations, whether by hand labour or machine. The appellant then submits that the eligibility of capital expenditure for reinvestment allowance shall be subject to whether that part of building or whether the plant or machinery is involved in the manufacturing process/activity, or transforming raw materials into an end product.

[15] With due respect, I cannot agree with this line of submission. The words "existing business" found before the words "in respect of manufacturing or processing of a product" must be read together as a whole, so that the expression "existing business in respect of manufacturing or processing of a product" is the more probable expression which is consistent with the intention of the Legislature in enacting para. 8(a) of Sch. 7A. Refer to *Metacorp Development v. Ketua Pengarah Hasil Dalam Negeri* [2011] 1 LNS 1002. If Parliament had intended reinvestment allowance to be restricted only to "production area", then Parliament would have surely specified this clearly in Sch. 7A. I agree with the respondent that by imposing the condition of "production area" to the meaning of "manufacturing", the appellant had clearly acted *ultra vires*, illegally and without jurisdiction as such was never the intention of Parliament. The appellant cannot be allowed to usurp the role of Parliament by coining its own definition of "manufacturing" and drafting its own law.

[16] The SCIT had analysed para. 8(a) of Sch. 7A and there is nothing in the appellant's submission to suggest that the SCIT had erred in their decision. The SCIT's reasoning as contained in paras. 10.13 to 10.16 of encl. 1 is self-explanatory.

[17] On the second issue, even the appellant's witness agreed that all the capital expenditures claimed for reinvestment allowance purposes were actually incurred by the respondent. During the cross-examination, he agreed that the respondent had made full disclosure in the Borang that were submitted in the Years of Assessment 2005-2007 and agreed that the audit team did not discover anything contrary to the information disclosed in the Borang. I therefore agree with the SCIT that the respondent had acted in good faith and made full disclosure. In *Ketua Pengarah Hasil Dalam Negeri v. Kim Thye & Co* [1992] 4 CLJ 2079; [1992] 1 CLJ (Rep) 135; [1992] 2 MLJ 708 it was highlighted that s. 113(2) of the ITA is not a mandatory provision. This section clearly confers discretion on the appellant as to whether penalty should be imposed or not. What more the matter in dispute arose as a result of technical adjustment ie, due to a differing interpretation of the tax legislation by the respondent. Therefore, the decision of the SCIT in the second issue to my mind is also correct.

Conclusions

[18] The SCIT was right when they relied on *Success Electronics*' case (*supra*) as the case binds them. The appellant should have also take the same step because unless and until the Court of Appeal sets aside the decision in *Success Electronics* (*supra*), the decision is a binding authority. Refer to *Metacorp Development's* case (*supra*).

[19] Under the circumstances, I affirm the deciding order of the SCIT dated 4 May 2012 and the appeal is therefore dismissed with costs.